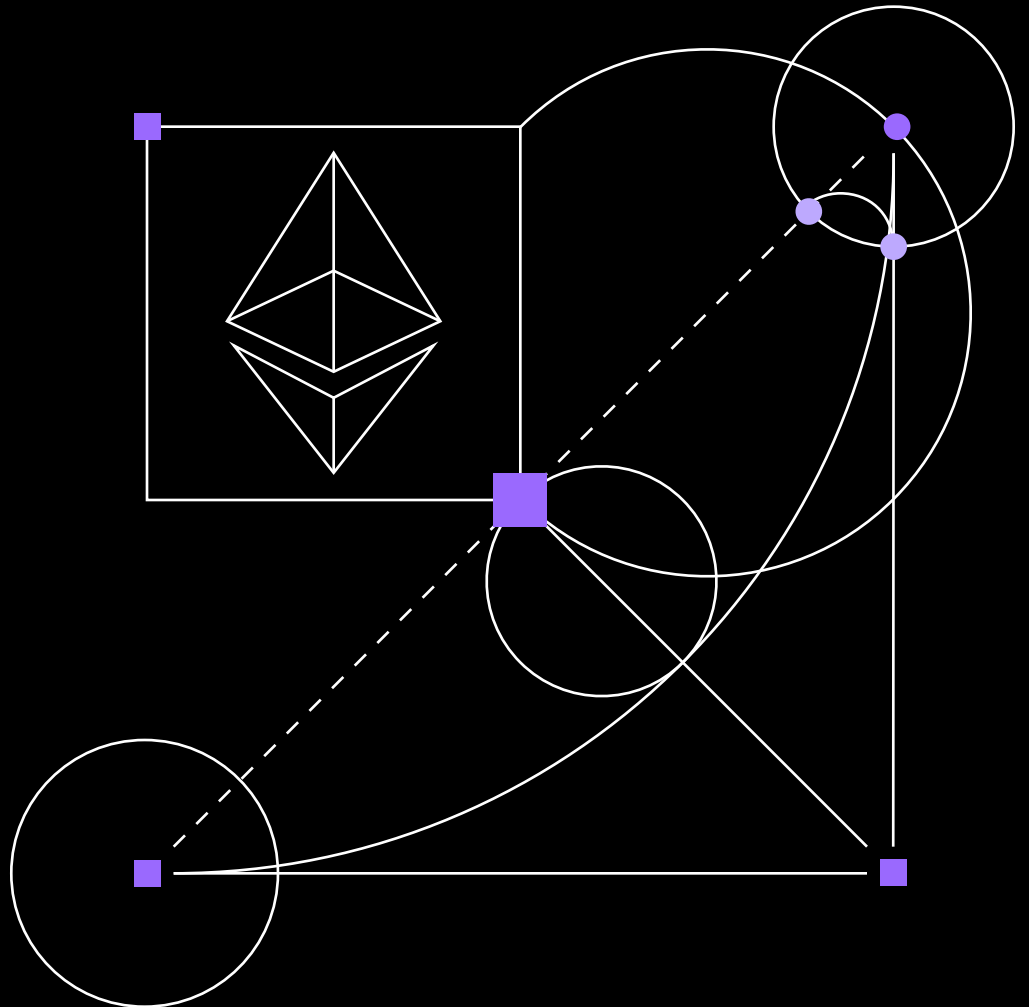




Galaxy Funds

Why Ethereum Now?

JUNE 2022





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Bitcoin may be the first and best-known digital asset. But the second-largest digital asset, Ether (commonly called Ethereum or ETH), also merits serious consideration by forward-thinking investors. The Ethereum blockchain has grown into the world's most actively used blockchain, with open-source rails that allow for decentralized applications to tap into its smart contract capabilities. As Ethereum continues its ascent, here are five tailwinds that we believe indicate the asset has more room to run.

Increasing engagement with the Ethereum network

Usage of the Ethereum network continues to grow and, as demonstrated by the number of active wallets, some experts claim Ethereum usage is outpacing that of bitcoin.

Ethereum has a remarkably robust developer community, spanning both ETH core developers and developers who build decentralized applications on top of Ethereum. Experts are calling the Ethereum blockchain a sponge for strong developer talent. Ethereum's current utilization rests around 51% after the implementation of EIP-1559.¹ This positive shift may lead to upward pressure on the price of Ether.² In addition, Ethereum is the most widely used collateral base in decentralized finance (DeFi) with 5.9M total locked value, or about \$7.2B.³ Outside of DeFi, other communities are being built on top of Ethereum, including NFTs, stablecoins, and other applications. Therefore, as developer engagement with the Ethereum network increases, we expect the asset to strengthen.

Ethereum blockchain improvements

The upcoming Ethereum upgrade to ETH 2.0, along with their recent implementation of EIP-1559 should make the Ethereum blockchain more scalable, secure, and sustainable. The two in conjunction are important because of the synergistic benefit achieved when you combine a Proof of Stake model (ETH 2.0) with a deflationary supply asset (Ethereum after EIP-1559). When sharding, the process of splitting a blockchain into multiple interconnected blockchains that work to independently process transactions, is combined with the power of off-chain rollups (encrypted packages of data) ETH 2.0 should be able to have 100,000 transactions per second (TPS), compared to its 15 TPS during ETH 1.0.⁴

Ethereum 2.0 is the initiative to increase the scalability of the Ethereum blockchain and switch from Proof of Work (PoW) to Proof of Stake (PoS). This transition provides several benefits:

- PoS is inherently faster and more efficient than PoW because validators only have to verify transactions. They no longer have to solve a mathematical "proof of work" equation.
- PoS requires less energy consumption than PoW, an important consideration as the digital asset industry moves towards climate-focused, sustainable, "green" initiatives.
- PoS aligns the operators upholding the network with the network/asset itself. Under a PoS system, the validator has to hold and stake the chain's native asset. So validators, by definition, hold a substantial amount of Ethereum and have a vested interest in seeing its value rise.
- Switching to PoS will allow Ethereum to implement sharding. This functionality should allow Ethereum 2.0 to host up to 100,000 transactions per second (compared to Ethereum's current 15 TPS), become more decentralized (phones will be able to run Ethereum), and have increased security due to reduced hardware requirements.

EIP-1559 went live in August 2021, changing Ethereum's transaction fee model through the implementation of a "base fee" that is algorithmically determined by the congestion of the network. This will work to reduce the volatility of gas fees on Ethereum by making them more predictable and stable. In addition, under EIP-1559, the base fee is now burned by the network and removed from the circulating supply, introducing a deflationary supply model for Ethereum. EIP-1559 carries the potential magnitude for impact on ETH's price comparable to a bitcoin halving event.⁵

The combination of Ethereum 2.0 and EIP-1559 will lead to more people using Ethereum, creating a more secure, decentralized network and enticing the number of people using Ethereum to increase – thus, further fortifying the network. The projected result of this is a deflationary asset increasing in both security and user activity.

1) Source: ycharts.com, as of 06/01/2022.

2) Source: [Bloomberg.com](https://www.bloomberg.com).

3) Source: DeFi Pulse, as of 06/14/22.

4) Source: [Co-founder Vitalik Buterin's forum post](https://co-founders.vitalikbuterin.com).

5) Source: Arca, 05/2021.



Ethereum is a natural next step for bitcoin holders

In the past few years, bitcoin has received outsized attention as a first mover and the largest digital asset. As bitcoin investors' comfort with crypto increases, their research and comfort often progresses to Ethereum. Investors then discover more palpable aspects of the network in terms of how they use the asset and what it means. Bitcoin was the breakout crypto asset; its lane focuses on its store of value properties, signifying bitcoin as digital gold. Ethereum, on the other hand, offers an entirely different use case, often referred to as Web 3.0. While bitcoin focuses on securely validating transactions (A to B), Ethereum is more of a mesh fabric offering greater flexibility as a network and allowing for more interoperability.

Ethereum benefits from the enthusiasm, curiosity, and familiarity that bitcoin has already forged on the investor's trail into cryptocurrency. We see continued interest in the exploration of Ethereum from an institutional perspective, an investment perspective, and a development perspective. Investors Warming to the Potential of Decentralized Finance Decentralized finance (DeFi) is a global, open alternative to traditional financial services. Substantially all of the DeFi ecosystem is being built on the Ethereum network. Advancements in blockchain technology empower DeFi developers to recreate the architecture of legacy financial systems with a code-based digital infrastructure of DeFi apps. These apps replicate traditional financial functions such as borrowing, lending, and exchanging assets, and they do so in a permissionless manner without relying on traditional financial intermediaries.

For financial professionals considering investing in the crypto sphere, DeFi is a more tactile, palpable adaptation. DeFi developers are using their familiarity with the way finance works now and looking at potentially better methods via more advanced technology. And while there is still a debate around exactly what bitcoin is, people are focusing more on the utility of the Ethereum network.

Increased institutional adoption and ease of access

Institutional adoption of Ethereum is gaining steam following Bitcoin's playbook in maturing as an institutional asset. Institutions and companies like the European Investment Bank and Visa have validated the Ethereum blockchain by announcing issuance and settlement use cases, respectively. Ethereum is gaining recognition from custodians as well.

Last December, Visa launched a multinational crypto advisory service for banking clients and merchants to assist clients and partners with crypto. Most recently, at the beginning of March 2022, President Biden signed an Executive Order outlining the first ever, "whole-of-government" approach to harnessing the potential benefits of digital assets and their underlying technology.⁶



Ethereum's last bull run was mainly tied to bitcoin's concurrent run. Five years later, Ethereum now stands on its own with clear, real-life use cases. The Ethereum blockchain will continue to mature as the base layer technology for smart contracts and decentralized applications. And Ethereum will stand to benefit as the next iterations of the internet and finance evolves.

6) Source: [White House Fact Sheet, 03/2022](#).



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Investment Risks Generally. An investment in the Fund, involves a high degree of risk, including the risk that the entire amount invested may be lost. The Fund will invest in Digital Assets (such as Bitcoin, Ethereum, other cryptocurrencies or blockchain based assets, including those that represent the Decentralized Finance (or DeFi) portion or sector of the digital assets market) using strategies and investment techniques with significant risk characteristics, including risks arising from the volatility of the global Digital Assets markets and the risk of loss from counterparty defaults. The Fund’s investment program may use investment techniques that involve substantial volatility and can, in certain circumstances, substantially increase the adverse impact to which the Fund may be subject. All investments made by the Fund will risk the loss of capital. No guarantee or representation is made that the Fund’s investment program will be successful, that the Fund will achieve its investment objective or that there will be any return of capital invested to investors in the Fund, and investment results may vary.

Different from Directly Owning Bitcoin, Ethereum or Other Digital Assets.

The performance of the Fund will not reflect the specific return an investor would realize if the investor actually purchased a Digital Asset. Investors in the Fund will not have any rights that Digital Asset holders have.

No Guarantee of Return or Performance. The obligations or performance of the Fund or the returns on investments in the Fund are not guaranteed in any way. Any losses of the Fund will be borne solely by investors in the Fund. Ownership interests in the Fund are not insured by the Federal Deposit Insurance Corporation, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity.

Regulation. Digital Assets, including Bitcoin, Ethereum and DeFi tokens, are loosely regulated. Ongoing and future regulatory actions may alter, perhaps to a materially adverse extent, the value of a Fund’s investment. If any Digital Asset is determined to be a “security” under U.S. federal or state securities laws or a Digital Asset exchange is determined to be operating illegally, it may have material adverse consequences for Digital Assets due to negative publicity or a decline in the general acceptance of Digital Assets. As such, any determination Digital Asset exchanges are operating illegally or that any Digital Asset is a security under U.S. federal or state securities laws may adversely affect the value of a particular Digital Asset or Digital Assets generally and, as a result, the value of a Fund’s investment.

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Value. Several factors may affect the price of Digital Assets, including Bitcoin, Ethereum and DeFi tokens, including, but not limited to: supply and demand, investors’ expectations with respect to the rate of inflation, interest rates, currency exchange rates or future regulatory measures (if any) that restrict the trading of a Digital Asset or the use of a Digital Asset as a form of payment. There is no assurance that a Digital Asset will maintain its long-term value in terms of purchasing power in the future, or that acceptance of bitcoin payments by mainstream retail merchants and commercial businesses will continue to grow.

Protocol. Many Digital Asset networks, including Bitcoin, Ethereum and DeFi tokens, operate on open-source protocols maintained by groups of core developers. The open-source structure of these network protocols means that certain core developers and other contributors may not be compensated, either directly or indirectly, for their contributions in maintaining and developing the network protocol. Lack of incentives to, or a failure to properly, monitor and upgrade network protocol could damage a Digital Asset network. It is possible that a Digital Asset protocol has undiscovered flaws that could result in the loss of some or all assets held by the Fund. There may also be network-scale attacks against a Digital Asset protocol, which could result in the loss of some or all of assets held by the Fund. Advancements in quantum computing could break a Digital Asset’s cryptographic rules. The Fund makes no guarantees about the reliability of the cryptography used to create, issue, or transmit Digital Assets held by the Fund.

Volatility & Supply. Values of Digital Assets have historically been highly volatile, experiencing periods of rapid price increase as well as decline. For instance, there were steep increases in the value of certain Digital Assets, including Bitcoin, over the course of 2017, and multiple market observers asserted that digital assets were experiencing a “bubble.” These increases were followed by steep drawdowns. For example, during the period from December 17, 2017 to February 5, 2018, Bitcoin experienced a decline of roughly 60%. During the period from February 13, 2020, until March 16, 2020, the value of Bitcoin fell by over 50%. Bitcoin had a strong start to 2021, hitting an all-time high of nearly \$65k in April. But, it closed H1 2021 down 47% from its record. Supply of Digital Assets is determined by computer code, not by a central bank. For example, uncertainty related to the effects of Bitcoin’s recent and future “halving” could contribute to volatility in the Bitcoin markets. The value of the Bitcoin or other Digital Assets held by a Fund could decline rapidly in future periods, including to zero.



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